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July 23, 2002

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station, 2nd Floor  
Boston, MA 02110

Re: Petition of Bay State Gas Company, pursuant to G.L. c. 164, § 94 and 220  
C.M.R. § 6.00 *et. seq.*, for authority to establish Gas Cost Incentive  
Mechanism, D.T.E. 01-81

Dear Secretary Cottrell:

Pursuant to the briefing schedule established by the Department of Telecommunications and Energy ("Department") in this proceeding, the Attorney General submits this letter as his Reply Brief to respond to the Initial Brief filed by Bay State Gas Company ("Bay State" or the "Company").<sup>1</sup> The Company's contentions in its Initial Brief are unsupported by the record evidence and lack merit, and the Attorney General reaffirms his position that the Department should reject the Company's Gas Cost Incentive Mechanism ("GCIM") since the Company's GCIM proposal would most likely raise rather than lower costs for its ratepayers while stifling competition in the gas supply market.

The Company contends that customers are likely to benefit from the GCIM proposal by paying less for gas under its proposal than under the current system,<sup>2</sup> and that GCIM proposal will

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<sup>1</sup> Other parties also filed initial briefs. The Attorney General supports AllEnergy Gas and Electric Marketing Company, L.L.C.'s Initial Brief urging the Department to reject the Company's GCIM proposal on the grounds that it violates the Department's incentive regulation rules and threatens the competitive market, and Massachusetts Community Action Program Directors Association, Inc.'s request that the Department dismiss the Company's Petition. The Attorney General opposes the Division of Energy Resources' recommendation that the Department approve the Company's GCIM proposal with certain modifications (e.g., restriction to residential class, limits on hedging activity, and defined termination conditions).

<sup>2</sup> The Company claims that its GCIM is patterned on the one used by Bay State Gas Company's local distribution company affiliate, Northern Public Service Company in Indiana. The Company further states that NIPSCO's GCIM has been a success. Co. Br., p. 6. Nisource's Security and Exchange Commission's 2001 Form 10-K directly contradicts this claim. According to the 10-K, the 2001 results for the GCIM were a loss. See Exh. DTE-7-1,

not impede competition in the gas supply market. *See* Co. Br., pp. 4, 10, 12, 13, 17. The Company, however, failed to rebut the record evidence or the Attorney General's argument that customers are not likely to benefit from the GCIM proposal<sup>3</sup> and that the proposal will stifle competition. *See* AG Br., pp. 4-7; Tr. 2, pp. 151-155, 161-163; Tr. 3, pp. 332, 339-342; Exh. AE-1. The Department, therefore, should reject the Company's Petition and its GCIM proposal.

Finally, the Company also claims that gaming could not be a part of the incentive mechanism and affiliate transactions. Co. Br., p. 22. However, as Mr. Newhard testified, gaming is a real and significant concern, particularly when monopolies are interfacing with unregulated affiliates and competing with in the retail market. Exh. AG-1, pp. 12-15. The obvious incentive is for the Company to leverage its monopoly position to bar any competitors from taking customers and to conceal the gaming in complex transactions in its ESS group which can and may commingle trading with regulated as well as unregulated affiliates. The gaming possibilities that occur are looked upon highly unfavorably by customers and the investment community alike. Similar incentive mechanisms in other states are currently being recognized for exactly those problems that have had devastating effects on other LDC's stock values. *See Illinois Commerce Commission Docket On Its Own Motion v. Northern Illinois Gas Company d/b/a NICOR Gas Company, Proceeding to review Rider 4 Gas cost, pursuant To Section 9-244(c) of the Public Utilities Act, ICC Docket No. 02-0067 (2002) (hearing reopened to investigate the company's accounting for gas cost trading with unregulated business partners and its incentive mechanism earnings as audited by Arthur Anderson).* *See* Updated RR-DTE-5 attached herewith.<sup>4</sup> The Department can prevent the likelihood of gaming by the Company by rejecting the Company's Petition and its GCIM proposal.

In conclusion, for these reasons, the Attorney General requests that the Department issue an Order rejecting the Company's Petition and its GCIM proposal.

Very truly yours,

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Wilner Borgella, Jr.  
Assistant Attorney General

WB/wb

cc: Michael Killion, Hearing Officer (w/enc.)  
Service List (w/enc.)

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NiSource 2001 SEC Form 10-K.

<sup>3</sup> The Company clarified in its Initial Brief that through its response in RR-DTE-3, it had modified its GCIM proposal by limiting recovery of administrative costs to no more than net gains or customer savings achieved. *See* Co. Br., p. 32; RR-DTE-3. Despite this modification, the Company neglects to consider the burden of other costs associated with the GCIM proposal. These other costs, for example, include financial costs which are not administrative in nature and for which customers ultimately will pay.

<sup>4</sup> The Company contends that the Attorney General's arguments concerning risks associated with the GCIM proposal are unfounded. Co. Br., pp. 21-27. The Attorney General submits that this contention is unfounded and contradicted by the record evidence in this proceeding.